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No. 91-798

In the Supreme Court of the United States

OCTOBER TERM, 1991

SOUTH DAKOTA PUBLIC UTILITIES COMMISSION, ET AL.,
PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

WILLIAM S. SCHERMAN
General Counsel

JEROME M. FEIT
Solicitor

TIMM L. ABENDROTH
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

QUESTION PRESENTED

Whether the court of appeals properly upheld a decision of the Federal Energy Regulatory Commission that the "area rate clause" in certain pre-1978 natural gas sales contracts entitled the natural gas producer to receive payment based on price ceilings that Congress subsequently established under the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.*

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 6a-22a) is reported at 934 F.2d 346. Its opinion denying rehearing (Pet. App. 3a-5a) is reported at 941 F.2d 1233. The opinions of the Federal Energy Regulatory Commission are reported at 48 F.E.R.C. (CCH) ¶ 61,177 (Pet. App. 31a-49a) and 50 F.E.R.C. (CCH) ¶ 61,288 (Pet. App. 23a-30a).

JURISDICTION

The judgment of the court of appeals was entered on May 24, 1991. A petition for rehearing was denied on August 20, 1991. Pet. App. 1a-5a. The petition

for a writ of certiorari was filed on November 18, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case involves the interpretation of "area rate clauses" in approximately 1200 natural gas purchase contracts between natural gas producers and Northern Natural Gas Company (Northern), an interstate pipeline. In general, those contract clauses authorized producers to collect from Northern the maximum regulated price allowed by the Federal Power Commission (FPC). The court of appeals upheld the conclusion of the FPC's successor, the Federal Energy Regulatory Commission (FERC), that the area rate clauses, although predating the passage of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, allowed the producers to collect the ceiling prices set by Congress in that legislation.

1. Prior to enactment of the NGPA, the FPC regulated natural gas prices pursuant to the Natural Gas Act, 15 U.S.C. 717 *et seq.* (NGA). Under the NGA, natural gas producers could collect from their interstate pipeline customers no more than what the FPC determined to be just and reasonable rates. Producers and their pipeline customers developed a variety of price escalator clauses that allowed the contractual price for the gas to escalate automatically with changes in the FPC-set rates. While the FPC rejected certain types of those contract clauses, it did approve and codify price escalator clauses that tied prices to the maximum "area ceiling rate" set by the FPC. See 18 C.F.R. 154.93(b-1) (originally promulgated by the FPC in Order No. 329, 36 FPC 925 (1966)). Thereafter, when the FPC began set-

ting nation-wide rates rather than area-wide rates, the FPC allowed producers and their pipelines to rely on those rate clauses in their existing contracts to escalate their contract prices to the national rate, notwithstanding the literal "area rate" language contained in the FPC's regulation and the gas contracts. *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 367 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1982).

When Congress enacted the NGPA, which replaced the FPC-established rates with congressionally established maximum prices, the question arose whether area rate clauses constituted sufficient contractual authority to permit producers to collect the NGPA prices from their pipeline customers. FERC concluded that the NGPA did not preclude reliance on area rate clauses as authority for charging NGPA rates. Order No. 23, [1977-1981] F.E.R.C. Stats. & Regs. (CCH) ¶ 30,040 (1979). In the Commission's view it was not an unreasonable interpretation of the parties' intent to conclude, as a general rule, that such clauses—even those that literally tracked the area rate clause language of the FPC regulation—authorized collection of congressionally set NGPA prices. The Commission went on to explain, however, that resolution of the question whether any particular "area rate clause" constituted sufficient authority to escalate prices to NGPA levels ultimately depended on the contracting parties' intent. *Id.* at 30,315-30,316. In Order No. 23-B, [1977-1981] F.E.R.C. Stats. & Regs. (CCH) ¶ 30,065, on reh'g, *id.* ¶ 30,073 (1979), the Commission established a rebuttable presumption that area rate clauses authorize NGPA prices where the contracting parties represent that to have been their mutual intent. *Id.* at 30,475-30,476. The Commission further provided

that third parties could rebut the presumption with evidence contradicting that stated intent. *Ibid.* The Fifth Circuit affirmed the Order No. 23 presumption and related procedures in all respects pertinent here in *Pennzoil, supra.*

2. In August 1979, Northern filed an evidentiary submission with FERC under the Order No. 23 regulations, stating that Northern and its producers had mutually intended to authorize payment of the highest applicable regulated rate—including NGPA ceiling rates—in 1200 of their gas purchase contracts. Petitioners and others filed "third party" protests, and an extensive evidentiary hearing followed. A FERC Administrative Law Judge (ALJ) issued an initial decision in which he found that the testimony overwhelmingly established that the parties intended the clauses to trigger payment of NGPA prices. 43 F.E.R.C. (CCH) ¶ 63,015 at 65,150-65,154 (1989); see Pet. App. 14a. In particular, the ALJ found persuasive the witnesses' testimony (1) that the area rate clauses had been designed to track the FPC's own regulations regarding permissible price escalator clauses, and (2) that the parties' intent was to permit Northern to offer producers the highest federally-authorized price for gas so that it could compete with intrastate pipelines—which were not subject to federal price limits—for limited supplies of gas to meet existing commitments to the interstate market. *Id.* at 65,154-65,158.

The Commission affirmed the ALJ's decision. It agreed that at the time Northern and its producers contracted, they intended the area rate clause "to trigger payments of all generally-applicable ceiling prices established by federal authority," including those that would later be established by the NGPA.

Pet. App. 31a-32a. The Commission denied petitioners' request for rehearing. *Id.* at 23a-30a.

3. The court of appeals affirmed the Commission's decision. Pet. App. 6a-22a. The court rejected petitioners' argument that they had satisfactorily rebutted the contracting parties' stated intent through evidence showing that those parties did not specifically know or anticipate, at the time that they entered into the contracts, that the FPC-pricing system would be displaced by the then-unenacted NGPA pricing scheme. *Id.* at 14a-16a. The court stated that the question, instead, was "whether the parties would have intended area rate clauses to authorize payment of NGPA rates if they had anticipated them at the time they negotiated the clauses." *Id.* at 16a. It concluded that the evidence strongly supported the conclusion that the parties would have intended the area rate clauses to have that effect. *Id.* at 16a-22a. Petitioners sought rehearing, arguing that the court had improperly affirmed the FERC decision on a rationale other than that of the agency—*i.e.*, on the parties' "reconstructed" intent rather than their actual, historical intent. The court rejected that argument, concluding that the "intent" standard the court of appeals applied and the one FERC applied were, in reality, the same. *Id.* at 4a-5a.

ARGUMENT

Petitioners contend (Pet. 8-13) that the court of appeals' decision amounts to a "*sua sponte* revision" of FERC's approach to the interpretation of area rate clauses. According to petitioners, FERC's inquiry here was whether, as a matter of historical reality, the parties intended area rate clauses to trigger payment of NGPA ceiling prices at the time they entered into the contracts. See Pet. 4, 9. Petitioners argue that the court of appeals departed improperly from FERC's rationale by reframing the inquiry to be whether the parties would have agreed to include congressionally set prices, as opposed to FPC-set prices, if they had been aware that Congress would so change the regulatory scheme. Pet. 6, 10. There is no merit to that contention.

The core premise of petitioners' argument—that the court of appeals affirmed FERC's decision based on a radically different conception of contractual intent than that applied by FERC itself—is erroneous. FERC, like the court of appeals, viewed the dispositive issue to be whether the parties' intent in agreeing to area rate clauses prior to enactment of the NGPA was broad enough to include agreement to the later-established, congressionally set prices, not whether the parties actually anticipated that Congress would set the prices. The court of appeals did not err in pointing out what is apparent to all: at the time the parties entered into their rate contracts, they could not have anticipated the specific nature of price escalation that would be imposed in the future. Rather than applying a different standard, the court of appeals simply clarified the precise nature of the problem addressed by FERC. There is no reason for this Court to review that assessment.

Neither FERC nor the court of appeals that originally reviewed its Order No. 23 regulations—see *Pennzoil, supra*—articulated a theory of "contractual intent" requiring parties to area rate clauses to establish that they had actually anticipated and formed a specific intent with respect to congressionally-set prices. On the contrary, in affirming the Commission's approach, the Fifth Circuit clearly recognized that the inquiry was one of determining the parties' intent "[i]n light of the changed circumstances brought about by the enactment of the NGPA." 645 F.2d at 389. Indeed, as the court of appeals here correctly pointed out, it is not uncommon—and certainly not legally erroneous—for a court to find a circumstance to be within the "intention of the parties" where the court is, more accurately, finding what the parties would have intended had they considered the precise question at hand. Pet. App. 5a. In short, there is no inconsistency between FERC's and the court of appeals' approach to the "intent" question in this case.*

Petitioners also argue (Pet. 14-20) that the court of appeals' decision is inconsistent with the statement in *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947), that "a reviewing court, in dealing with a determination or judgment which an administrative agency

* Ultimately, petitioners' real disagreement appears to lie with the Commission's conclusion in its Order No. 23 rulemaking that, as a general proposition, it is not an unreasonable interpretation of area rate clauses to conclude that they constitute sufficient authority to collect congressionally-set NGPA rates, notwithstanding the specific reference in those clauses to the FPC-set "area rate." That position is no longer open to petitioners, however, because the Commission rejected such a "plain meaning" argument, and the Fifth Circuit affirmed. *Pennzoil*, 645 F.2d at 387-390.

alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency." There is no merit to this argument. As the court of appeals explained, "courts themselves commonly use the language of historic intent in situations that are really ones of hypothesized or reconstructed intent," and it "is hardly a violation of *Chenery* for a reviewing court to infer that the agency's usage was, similarly, a kind of shorthand." Pet. App. 5a, citing *Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281 (1974).

Finally, petitioners' suggestion that the court of appeals conferred a windfall on the contracting parties by imposing prices in excess of the market price and in excess of prices actually paid by Northern (Pet. 7, 17-18) is incorrect. FERC's orders, as upheld by the court of appeals, simply determined that the area rate clauses, when read in isolation, authorize collection of the NGPA ceiling prices. They did not determine, however, the precise price payable by Northern under its supply contracts; nor do they require Northern now to increase its payments above the level it has been paying since the market price dropped substantially below the ceiling prices. As the court of appeals correctly pointed out (Pet. App. 21a), the analysis in this case regarding the impact of area rate clauses does not affect any price reduction claims that may be resolved through negotiation or litigation between the parties under other contract clauses or contract doctrines. See *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 111 S. Ct. 615, 624 (1991) (not only are the NGPA-authorized ceiling prices "squarely within the 'zone of reasonableness' mandated by the NGA,"

but also FERC has established procedures for parties to negotiate reduced prices).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

WILLIAM S. SCHERMAN
General Counsel

JEROME M. FEIT
Solicitor

TIMM L. ABENDROTH
Attorney
Federal Energy Regulatory Commission

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